United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

75-5025-6

IN THE

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

DOCKET NO. 75-5025-6

In re

CONTINENTAL VENDING MACHINE CORP. and
CONTINENTAL APCO, INC.,

Debtors.

JAMES TALCOTT, INC.,

Appellant,

IRVING L. WHARTON, TRUSTEE,

Appellee.

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE EASTERN
DISTRICT OF NEW YORK

APPELLANT'S REPLY BRIEF

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STATUTES

1. STANDARDS

The Appendix to Judge Mishler's decision does not reveal that he allowed reimbursement for services within the language of the security agreement (Tr.Br.6). For that revelation examination of the judge's rulings is required, and these yield no clear or consistent pattern of the standards applied. Most services were disallowed under §243 in whole or in part; not part of any plan of reorganization or administration of the estate (165a); not enforcing payment though debtor benefitted (168a); only an indirect benefit to the estate (170a); not to protect or preserve the debtor's assets (172a); indirect benefit (174a); not connected with financing agreements and not in aid of administration (175a); if improper under §243, cannot be proper under the agreements (176a); only indirectly related to the agreements (179a); only an indirect benefit to the estate (182a); not enforcement of collection or protection of the estate (184a); only an indirect effect on Talcott's security (184a); only Talcott's benefit (185a); only for Talcott's benefit not for the debtor's (186a); not compensable under §243 (187a); no benefit to the estate (187a).

Other services were allowed apparently because in aid of administration though not within the language of the

agreements (166a-167a). Barring oversight, there appears to be only one instance of an allowance for enforcement of collection under the agreements, but even this is coupled with a found aid in administration of the estate, "therefore, these services are reimbursable under Section 243." (174a) There is no doubt that §243 predominates and is meant to be largely controlling.

The trustee does not cite a case holding or suggesting that §243 is applicable. Nor does he dispute Talcott's assertion that the cases cited below deny rather than support §243 applicability (Tal.Br.14-15). The trustee has no answer to In re Neil Properties, Inc.,360 F.Supp.914 (D.Cal.C.D.1966) or to Sampsell v. Monell, 162 F.2d 4 (9 Cir.1947) (Tal.Br.16). He does not explain absence of mention of §243 in the order of reference. (Tal.Br.15-16) Subject only to state law, the language of the agreements is the sole determinant of compensability, not in conjunction with §243, as the trustee claims. (Tr.Br.6)

Matter of Gossage, 6 CBC 428 (W.D.Mo.1975) and In re Cambridge,(D.Mass.1974), unreported, (Tr.Br.11-13) deal with determination of reasonable amount not standards of compensability. If services are within the language of the agreement, it is believed that they cannot be disallowed merely because all of them are compensable.

The trustee ignores the rule that time spent is not the only standard. In re Borgenicht, 470 F.2d 283 (2 Cir.1972) (Tal.Br.20); Mass. Mutual L. Ins. Co. v. Brock, 405 F.2d 429, 432 (5 Cir.1969), cert. den. 295 U.S.906; Westec Corp., 313 F. Supp.1296, 1302 (S.D.Tex.1970). Application of wrong standards is an abuse of discretion requiring reversal. Mass. Mutual, supra, at 432.

2. HOURLY RATES

Talcott's counsel never "claimed" or "relied upon" their earlier or the later increased hourly rates. (Tr.Br.6-7) These rates were for clients charged on an hourly basis. Talcott was not so charged. Time spent was given some consideration; the principal standard was results achieved in each case. Reasonable fees were tacitly, sometimes expressly agreed upon in a long-standing lawyer-client relationship (431-434, 436-437,705).

That changes in private practice are not controlling in bankruptcy is well established [Ruskin v. Griffiths, 269 F.2d 827 (2 Cir.1959); Finn v. Childs,181 F.2d 431 (2 Cir. 1950)] and well known to Talcott and its counsel. Acceptance without objection to Judge Mishler's hourly rates in the Automatic Canteen ligitation, 318 F.Supp. 421 (Tr.Br.7) , was

motivated solely by a desire to avoid adding another issue in a complex and hotly contested controversy. Those rates are by no means acceptable and could have been contested on a number of grounds including the difference in time span of the services. In this case some of the services were performed later, when rising costs of running an office are taken into consideration and affect the award. In re Webb & Knapp,Inc., 363 F.Supp. 423 (S.D.N.Y.1973)

3. REFERENCE AND SCOPE OF REVIEW

Although propriety of the reference here is itself not in issue, it is thought to be not altogether irrelevant in the context of the scope of review. C.A.B. v. Carefree Travel, Inc., 513 F.2d 375 (2 Cir.1975) (Tr.Br.8-9) is distinguishable in that it did not involve allowances. Newman & Bisco v. Realty Associates etc., 173 F.2d 609 (2 Cir.1949) (Tal.Br.17) does involve allowances; a showing of "exceptional circumstances" is still required and it is not present here. La Buy v. Howes Leather Co., 352 U.S. 249 (1957) Judge Mishler had referred at least one other phase of this proceeding to Bankruptcy Judge Costa.

The point persists: Having made the reference,

the judge is bound by Rule 53e(2), F.R.C.P.; he must accept the master's findings unless they are clearly erroneous. (Tal.Br.18) The trustee is disturbed. He need not be. The Rule d' s not "mandate acceptance" of the master's findings; it does not mean abandonment to the magistrate of the judge's prerogatives or action "as a rubber stamp." (Tr.Br.9) The Rule applies to findings of fact only, not rulings on the law. Compensability, exercise of discretion, standards and the like are matters of law as to which the judge is free to review and overrule the master for error. Here, the judge overruled the master's fact findings which are not clearly erroneous (Tal.18-19).

4. ITEMS OF SERVICES

Only a small fraction of items can here be all too briefly considered and not in numerical sequence. Claimed errors with respect to all other items are not waived.

XIV- SATISFACTION OF SUPERIOR LIENS ON THREE ROUTES. Reduction of hours from 50 allowed by the master to 25 is justified by the trustee on the ground that the judge in charge of the proceedings since 1963, is better qualified to estimate the time spent (Tr.Br.23-24). There is no basis for the asserted better qualification. There was no litigation,

no appearances before the judge and no orders entered. There were only out-of-court conferences, negotiations with attorneys for two lienors and trustee's counsel resulting in substantial reductions of their claims. (300-301, 1074-1075) The judge has no personal knowledge of these services.

XVI - EXAMINATION OF TALCOTT'S OFFICERS. As with all services, the only question is whether they come within the language of the agreements. And the trustee does not squarely meet (Tr.Br.pp.24-25) Talcott's showing that these services are within the language. (Tal.Br.28)

The fact that Talcott was not a defendant in the action is irrelevant. There was intimation "that the trustee intended to revoke or dishonor the general release" he gave Talcott as an inducement for the $750,000 loan, "and that it was likely or possible" that the examination "was for the purpose of laying the groundwork for" a later action. (1015-1016) It was obvious that the examination did not relate "to any of the causes of action in the complaint." (1031) In the course of the examination, trustee's counsel "voluntarily" assured Talcott "that the trustee had no intention and would, under no circumstances, try to * * * circumvent the general release * * *; that both he and the trustee considered this a matter of honor * * * and no such attack * * * on any grounds was in contem-

plation." (1035)

Yet contrary to those assurances, the trustee advised "that the facts with respect to the causes of action against Talcott would have to be developed." (1039) And only a short time later, the trustee commenced a proceeding against Talcott to recover $350,000 as a preference (1039)under §60 of the Bankruptcy Act. (176a, note 18) The preference claim was expressly covered by the release, (957) as the judge recognizes. (179a, note 20)

The trustee rests on Judge Mishler's ruling that the examination "was only indirectly related to the financing and factoring agreements". The relationship was direct; the preference action challenged Talcott's right, upon loss of lien on the assigned accounts which proved spurious, to obtain payment out of other security under its general lien provided for in the agreements. (Item XI, Tal.Br. 25a-26a)

IX - PROOFS OF CLAIM. The judge disallowed these services "for the reasons stated above." (175a) Asserting this ruling is "proper", (Tr.Br.21), the trustee does not suggest what "the reasons stated above" are. They are not the trustee's novel reasons, unsupported by any authority. He would limit compensability to cases where the proof of claim, as a means

of collection, is "the only work done by the attorney". He would deny compensability where other collection services are allowed. The other services relate to collection out of security. These proofs of claim include claims against the estate for any unsecured debt remaining after the security is exhausted. (Claimant's Exhibit 3B)

III and IV - $650,000 LOAN AND SALE OF ROUTES PURSUANT TO AUGUST 14, 1963 AGREEMENT. These items involve the Silco reserve of some $260,000 which Judge Judd awarded to Talcott for application against Continental's indebtedness. (95a et.seq.) This is a collection. The related services are compensable under Judge Mishler's standards. Yet he disallowed the services. (167a-170) The trustee supports the decision by urging that the services were not to enforce payment and the loan was used by the debtors as working capital not to satisfy debts to Talcott. (Tr.Br.18-19)

In whole or in part, the routes were Talcott's security. Only by a sale of the routes could Talcott collect Continental's debts. The trustees operated the routes without servicing Talcott's loans. For a period they could not or would not sell the routes. They urgently needed $650,000 capital and they finally agreed to sell the routes if Talcott made the loan.

And, with respect to the two California and one Buffalo routes, they imposed the further conditions that Talcott obtain a purchaser of these routes for $2,850,000. To achieve the sale of the routes and collect the secured debts, Talcott agreed to the conditions.

Talcott found a willing purchaser, Silco, who needed financing. There was no certainty that pending negotiations would be successful. Time was of the essence. If Talcott failed to produce a purchaser within a fixed short period, the routes would not be sold. Talcott created a purchaser; it formed a subsidiary, Dana, to make the timely offer. If the Silco negotiations should fail, Talcott was prepared to operate the routes through Dana. The offer was made. The Silco negotiations did succeed. Dana assigned the offer to Silco. $2,850,000 was paid to Talcott. It credited this amount to Continental, in satisfaction of its own liens, satisfied the known liens of others and kept $260,000 in reserve (the Silco reserve) for any then unknown liens. The ultimate result of all this was a collection of some $2,400,000 in payment of Continental's debt.

Judge Mishler and the trustee view the $650,000 loan in isolation. Properly viewed in context, the loan was made for the purpose of collecting out of security, which purpose was achieved. The necessity of legal services in the

complex transactions was not attributable to Talcott making a simple loan. The transactions and related services were the unavoidable consequences arising from the peculiar nature of the collateral and the conditions which the trustees imposed.

The trustee's unwillingness or inability to sell the routes constituted a barrier to Talcott's access to its security. The loan was made to remove the barrier. Services rendered to accomplish this result and make collection possible are within the language of the agreements and are compensable.

V - $750,000 LOAN. These services were held to be not compensable upon the view that they were in connection with a loan, in total disregard of the underlying facts and circumstances. The $650,000 loan in August, 1963 was made as an inducement to sell the routes. The $750,000 loan in October, 1963 was made as an inducement to get the trustee's restatement of collateral and general release.

Trustee's counsel let it be known that a mass action was contemplated including Talcott as a defendant and the only way to avoid the action was to continue to support the debtor's operations. (879) The trustee himself approached Talcott's counsel for an urgently needed $750,000 loan, offering in return a general release (882).

At the time, trustee's counsel threatened all sorts of theories for attacking Talcott's liens, questioning the validity of the liens which he said were under investigation (936, 930). To protect Talcott's lien position (931), to establish once and for all the validity of the liens, to preclude future disputes and to fix the amount of debtors' and trustee's obligations to Talcott (936, 922-923), Talcott agreed to make the loan (with Franklin National Bank) on the condition, among others, that there should be a restatement of collateral, a sort of account stated, and that the trustee give Talcott a general release (921-923).

Talcott insisted on the restatement (968). The trustee offered the release; he "dangled" it before Talcott's counsel; it was his talking point (921-922).

Having obtained the restatement and release, Talcott no longer had to be concerned about an attack on its liens by the trustees (1937). It was in the nature of removal of cloud on title. The loan was unique. Talcott does not enter into loan transactions in order to avoid threats of lawsuits every day of the week (920-921). It would not have made the loan to anyone other than Continental (947).

Part of the attorney's services related to preparation of the restatement which required numerous conferences with

Talcott's personnel, largely with Goldberger (904-906, 957-958, 959, 962). Goldberger testified to substantiate Talcott's claim for auditing and other charges including preparation of the re-statement (1491-1494) and consultations and conferences with Talcott's attorney (1494-1495). The court allowed the claim for these auditing charges; inconsistently it disallowed the legal charges.

As it turned out, the restatement of collateral and the general release played a significant role in Talcott's re-covery of some $260,000 of the Silco reserve in payment of Continental's pre-petition obligations to it, as decided by Judge Judd (107a-111a, 118a-120a).

XX - MISCELLANEOUS. It is all very well for the trustee to rely on Judge Mishler's "careful and studious review and findings" which disallow all these services (Tr.Br. 26). It is another matter to see how correct and proper Judge Mishler's determination is.

Restatement of collateral, Schedule B of some 40 pages, lists large numbers of machines in numerous warehouses all over the country and subject to Talcott's liens (1394-1396). Many of these machines were in disrepair; to make them sellable, they had to be refurbished and rebuilt. By letter agreements of

February 4 and 5, 1964 (El. Exh.B5, B6, 1400-1403) it was arranged that, to the extent possible, the trustees would put the machines in sellable condition and they would sell them, and all other machines that did not require repair, at a compensation of 25% of the sales price. The negotiations for this arrangement were conducted by Talcott with the trustee's representative, William Rapp, but Talcott's attorneys had to work out the details, terms and conditions of the agreements, they prepared the agreements, submitted them to the trustee's counsel and had them approved by the two trustees.(1404, 1405)

Pursuant to the agreements, the machines were sold for about $500,000 (Fairberg, 1639). Talcott's auditors rendered considerable services in connection with those machines (Goldberger, 1485-1499). Judge Mishler allowed the claim for these auditing services (189a-190a). He disallowed the claim for the related legal services in connection with the agreements pursuant to which the machines were reconditioned and sold.

That the services in connection with Talcott's loans and many other matters and activities benefitted the estate and creditors is unquestioned. "* * * except for Talcott's large

infusion of capital, there might be nothing at all for the unsecured creditors." (Judge Anderson, dissent, 517 F.2d at 1005)

"The trustees' success in obtaining funds from Talcott * * * permitted the debtors to continue production of acceptable products for the 1964 market, and ultimately permitted the sale of Continental's manufacturing operation as a going concern." (Trustee's Report, Claimant's Exhibit PPP, p.17)

"It would have been impossible for the debtors to continue their operations had it not been for the loan of $300,000 made to the Conservator by Talcott ($200,000) and Franklin ($100,000). This loan was not the type which either of these lending institutions would have made under normal circumstances. No specific collateral was pledged to secure that loan. The lending institutions were limited to charging 6% interest. Subsequently Talcott advanced to the debtors an additional $175,000 under similar circumstances, when no payment on the prior loan had been made; later Talcott advanced an additional $200,000; finally Talcott advanced $650,000, * * * (Trustee's application for order authorizing the $750,000 loan, Claimant's Exhibit BB, pp.10-11). The only reason for making the loans was to preserve and protect Talcott's security and to collect the indebtedness. Millions of dollars were recovered by this collection process. Judge Mishler allowed nothing for

the legal services involved.

In view of master's findings concerning benefits to the estate, results accomplished, amounts involved and counsel's expertise and standing, all well established standards, the allowance of $150,000 might well be considered modest. Even if there should be doubt, and there is none, about compensability, or time spent or any other element in respect of any one or more item of services, the allowance is so soundly grounded in reason, in fairness, in judicial discretion and in evidence that in this appeal it "should not be whittled away" by one cent. In re Polycast Corp., 289 F. Supp. 712 (D.Conn.1968)

5. DISQUALIFICATION

Judge Mishler recused himself on the Silco issue in the September 4, 1974 order for the sole reason that he had "expressed an opinion concerning the intent of the agreement." (41a-42a) The first intimation that the trustee would call Judge Mishler as a witness appeared at a preliminary conference before Judge Judd on May 5, 1975 (198a). There is no basis for the trustee's statement that advice of the trustee's intention to call the judge as a witness was also a reason for his recusal (Tr.Br.33).

The trustee urges that refusal to disqualify is proper because the judge was not a witness "in the matter in controversy" as provided in 28 U.S.C. §455, amended effective December 5, 1974. The amendment is not applicable to "any proceeding commenced prior to the date of this Act (Dec.5,1974), * * *". Section 3 of Publ.L. 93-512, 28 U.S.C., Cumulative Pocket Part for 1976, p.18. The instant proceeding was commenced in September, 1972 by Talcott's motion for payment of certificates and the trustee's counter-motion for an accounting. The proof of claim in issue is part of the accounting and it was filed on April 30, 1974.

The trustee's procedural objections are irrelevant. They were not raised or decided below. Disqualification is the obligation of the judge himself. No action on the part of a party is necessary. Prior requirement for such action was eliminated by the amendment of 1948. United States v. Amerine, 411 F.2d 1130, 1131 (6 Cir.1969). Disqualification "is a matter which transcends the interests of the parties. The purity of the judicial process and its institutions is the thing at stake." Kinnear-Weed Corp. v. Humble Oil & Refining Co.,403 F.2d 437, 439-440.

Having maintained his preference action for ten

years, the trustee now says it was "settled by withdrawing the claim". (Tr.Br.36) The action was in violation of the trustee's general release. It was kept alive by no less than about 80 consent adjournments before Judge Mishler. The trustee withdrew it in 1975 when Judge Mishler notified the parties he will require an application for any further adjournments. This is how the trustee "settled" the preference action against Talcott.

Judge Mishler knew of the release. Not only did he sign the order authorizing it, he signed his approval at the foot of the release itself, an unusual judicial act. He knew the action violated the release and he knew of the 80 adjournments. The trustee complains that Talcott suggests collusion as proof of actual prejudice. Talcott suggests no such thing. Apparent prejudice arising from being a witness is the only requirement for disqualification. Talcott points to the record merely to reinforce the charge of apparent prejudice and to suggest confidence that disqualification in the particular facts and circumstances of this case was and is imperative.

Finally, the trustee did not make any "settlement" with Talcott on distribution of proceeds of sale of the routes. The settlement was "among other creditors" claiming their shares on the distribution. (Tr.Br.36) The trustee did not have claims

against Talcott or the other creditors that were settled by him. The trustee held the proceeds for over five years although Talcott several times requested distribution. As a stakeholder, the trustee only did what was required of him in the proceedings. His counsel received claims against the funds; the meetings were held in the trustee's counsel's office and his accountants worked out distribution formulae.

CONCLUSION

The requested relief in Talcott's main brief is revised to the extent of requesting a remand for assignment to another judge not only of the subject matter of the November 18, 1975 order, but of all outstanding controversies between Talcott and the trustee.

Respectfully submitted,

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C 375—Affidavit of Personal Service of Papers on Individual. ✓

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UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

Docket ~~Index~~ No. 75-5025-6

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CONTINENTAL APCO. INC., Debtors

~~Plaintiff~~

JAMES TALCOTT, INC. ~~against~~ Appellant

IRVING L. WHARTON, TRUSTEE,

Appellee
~~Defendant~~

Affidavit of Personal Service

STATE OF NEW YORK, COUNTY OF NEW YORK *ss.:*

ANTHONY VAUGHN VENNER *being duly sworn,*

deposes and says that deponent is not a party to the action, is over 18 years of age and resides at
65 East 97th Street, New York, N.Y.

That on the 7th *day of* May *19* 76 *at* 1251 Avenue of Americas

deponent served the annexed APPELLANT'S REPLY BRIEF *upon*

JOSEPH J. MARCHESO, Esq., attorney for the Appellee

~~the~~ Two ies *in this action by delivering a true copy thereof to said individual* 's office, said individual not being present.

~~personally~~. *Deponent knew the person so served to be the person mentioned and described in said papers* ~~office~~ office of the person so mentioned *as the* said attorney for appellee *herein,*

GEORGE COHEN
Notary Public, State of New
No. 31-0682100
Qualified in New York County
Commission Expires March 30, 1977

Sworn to before me, this 7th *day of* ~~7th~~ May *19* 76

George Cohen
GEORGE COHEN,
Notary Public, State of New York
No. 31-0682100
Qualified in New York County
Commission Expires March 30, 1977

Anthony Vaughn Venner
Print name beneath signature
ANTHONY VAUGHN VENNER

2 Copies Received

Date May 7, 1976

Firm Joseph J. Mauchan, Esq.

By